

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 00-0198
Gross, Adjusted Gross and Supplemental Net Income Tax
For The Period 1996 through 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Gross, Adjusted Gross, and SNIT – Unrelated Business Income

Authority: IC 35-45-5-3; IC 6-2.5-5-25; IC 6-2.1-3-23; IC 6-3-2-3.1(a); IC 6-3-1-17(a); 45 IAC 3.1-1-68.

The taxpayer protests the imposition of gross, adjusted gross, and supplemental net income tax on proceeds from illegal gambling machines.

STATEMENT OF FACTS

As a result of a charity gaming investigation conducted by the Department's Criminal Investigation Division, and an interview with the taxpayer's Quartermaster, four (4) "cherry master" illegal gambling machines were discovered in the taxpayer's location.

Gross, Adjusted Gross, and SNIT – Unrelated Business Income

DISCUSSION

Under Indiana Code section 35-45-5-3 the four (4) gambling machines operated in taxpayer's establishment constitute illegal gambling. Proceeds from illegal gambling are considered unrelated business income and subject to Indiana gross, adjusted gross, and supplemental net income tax. The amount of gross income from illegal gambling machines is estimated yearly at \$104,000 per machine. However, the Department only attributed \$26,000 per machine for a total of \$104,000. As a result, the amount of tax due and owing is \$4,030 per year.

First, the taxpayer contends that the machines are not illegal and are for amusement purposes only. Second, taxpayer protests the imposition of gross, adjusted gross, and supplemental net income tax on proceeds from the machines. Third, the taxpayer states that the amount of money attributable to the machines was significantly less according to their records.

According to the Department's criminal investigation division, the four (4) gambling machines found in taxpayer's establishment were what the industry calls "cherry master" machines.

IC 35-45-5-3 provides in pertinent part:

A person who knowingly or intentionally: ... (3) maintains, in a place accessible to the public slot machines, one-ball machines or variants thereof... commits professional gambling, a Class D felony.

The Department determined that activities of taxpayer were unrelated to taxpayer's exempt purpose. Exemption from tax for exempt organizations is tied to the gross income tax provisions with respect to exempt organizations. IC 6-2.5-5-25. As provided under IC 6-2.1-3-23, exempt organizations are not entitled to exemption from gross income received by a taxpayer that is derived from an unrelated trade or business, as defined in Section 513 of the Internal Revenue Code. Thus, the Department's determination was guided by I.R.C. § 513, which provides, in part, the following:

...The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Pursuant to IC 6-3-2-3.1(a) and IC 6-3-1-17(a), the Indiana General Assembly has expressly adopted the Code's tax treatment, with respect to Code section 501(c) organizations, for purposes of the Indiana adjusted gross and supplemental income tax analysis. Moreover, the Department's rule 45 IAC 3.1-1-68 defines an unrelated trade or business under the same guidelines as Code section 513, and the rule also subjects any unrelated business income to the Indiana taxes. Additionally, the rule cites taxpayers to Code sections 511 through 515 for guidance in determining whether income is subject to the taxes.

The taxpayer, in support of its protest, provided collection reports from June through December of 1999. These collection reports consist of carbon copy receipts showing the date, year, taxpayer's name, the net amount to divide, the merchant's share, and the balance due the operator. The receipts are signed by a representative of the taxpayer and the individual servicing the machines. The receipts allegedly show the following dates

and net amounts for the four machines: 6-6, \$400; 6-7, \$164; 6-12, \$450; 6-19, \$300; 6-21, \$500; 6-28, \$400; 7-26, \$100; 8-2, \$300; 8-9, \$506; 8-16, \$108; 8-23, \$166; 8-30, \$246; 9-7, \$686; 9-13, \$508; 9-20, \$450; 9-27, \$504; 10-4, \$300; 10-11, \$450; 10-25, \$200; 10-25, \$300; 11-1, \$770; 11-8, \$250; 11-15, \$450; 11-22, \$100; 11-29, \$150; 12-6, \$450; 12-13, \$1000; 12-20, \$250; 12-27, \$250.

According to the taxpayer, the reports show their one-half (1/2) share of the gross proceeds for the seven (7) months of 1999 to be \$12,540 (on average \$1,791.42 per month or \$59.70 per day). The taxpayer only receives one-half (1/2) of the total proceeds pursuant to an agreement with the corporation that provides the machines. The taxpayer argues that these reports are accurate, since they are verified with affidavits by both employees of the taxpayer and of the corporation.

The Department's Charity Gaming Annual Report dated October 1, 1999, shows that the taxpayer reported approximately \$431,467 in gross revenues from only pull tab sales. The taxpayer's affidavits state that the taxpayer averages ten (10) to fifteen (15) visitors a day. If the taxpayer is open 324 days a year (per affidavits) with 15 visitors a day (per affidavits) that would average out to almost \$89 per day spent by each person on pull tabs alone. It is obvious that the number of visitors to the taxpayer's establishment is greatly understated. This calls into question the accuracy of the receipts provided to the Department. A review of the receipts, showing identical signatures, also tends to support the Department's position that they were all written at the same time.

FINDING

The taxpayer's protest is denied.

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